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## ECONOMISTS PREDICT SOFT LANDING FOR HOUSING

WASHINGTON, April 28 – After soaring to record levels for three consecutive years, the single-family housing market is gliding toward a “soft landing” in 2006, as rising interest rates, affordability issues and a reduced role for investors/speculators contribute to a softening in demand, according to economists at the National Association of Home Builders (NAHB) Construction Forecast Conference in Washington, D.C. on April 27.

“After topping out in the third quarter of last year, it is pretty clear that the housing sector is in a period of transition. Sales and starts are trending lower toward more sustainable levels,” said NAHB Chief Economist David Seiders. Even so, the slowing housing market is not likely to derail the expansion as housing yields its position as the economy’s major growth engine to other sectors, he added.

Expressing a similar assessment, Michael Moran, chief economist at Daiwa Securities America Inc., said: “The housing sector is going through an adjustment, not a collapse.”

Taking a bullish view on the current economic and inflation outlook, Jim Glassman, managing director and senior policy strategist with JP Morgan Chase & Co., said these factors will bode well for housing.

“Real estate is pricing itself back to reality and in the long-run it is reasonable to expect starts in the 1.8 million to 2 million range,” said Glassman. “Housing won’t continue to make the same contribution to the economy that it has. But when I think about where the economy is, I think we’re in the fifth inning with a good chance of going into extra innings. This expansion may prove to be the longest one ever seen.

“Inflation is key to the longevity in the current economic expansion and to the underlying health of the building business,” he said, noting that Federal Reserve Board policymakers are doing an excellent job of keeping inflation in check.

Economists agreed that the Fed will raise its benchmark short-term rate to 5 percent at its May 10 meeting, which would be the 16th consecutive quarter-percentage point increase since the Fed started lifting it from 1 percent in June of 2004.

Both Seiders and Glassman believe the 5 percent mark should be enough to ease inflationary pressures in the months ahead and to keep the Fed from moving forward with additional rate hikes. However, citing higher energy prices and a low unemployment rate of 4.7 percent, Moran predicted that the central bank won’t stop until it raises the federal funds rate to 5.5 percent.

Looking to the future, Seiders said that new home sales in the first quarter of this year were down 10 percent from the fourth quarter in 2005, and that he expects them to ease further in the coming months before leveling off in 2007.

NAHB is forecasting that new home sales will hit 1.13 million units in 2006, down 12 percent from last year's all-time high of 1.28 million units, and then move down slightly in 2007 to 1.09 million.

"Hopefully, most of this decline will be due to investors and speculators stepping out of the market. What we don't want to see is investors dumping homes on the market," said Seiders.

After posting a record 1.716 million single-family starts in 2005, NAHB is predicting that new home construction will level off to 1.595 million units in 2006 and 1.488 million in 2007, which would still rank high by historical standards.

Commenting on the dramatic home price increases in many markets in recent years, Seiders said home price appreciation is expected to fall from an average 12 percent in 2005 to about 4 percent in 2007 and that mortgage rates should move up to 6.7 percent later this year.

Seiders added that the multifamily market has remained "eerily stable" since the late 1990s, and is expected to continue the same pattern in 2006, with starts dropping slightly to 351,000 apartment units from 355,000 last year.

The rental market has solidified, and Seiders said he expects it to regain some ground while the red-hot condo markets start to cool. Seiders is also predicting that residential remodeling expenditures will continue on an upward trajectory, in part because "an immense amount of home equity will continue to support this spending."

## The Regional Outlook

Looking at housing on a more localized level, Bernard Markstein, NAHB's Director of Forecasting, said that the forces driving housing demand vary significantly by region. Among the forces affecting demand are home prices, population growth, household formation, and growth in employment opportunities. Other factors that can greatly affect demand include immigration and migration, energy prices, large-scale natural disasters such as Hurricane Katrina, and an area's appeal as a second home location.

Mark Zandi, chief economist for Moody's Economy.com, said that "builders have done a pretty good job of matching supply and demand" and that "nationally, house prices and supply will go flat in 2006, 2007 and 2008." This implies that there will be some price declines in key markets, he said, but the markets are going to "correct, not crash."

Markets where Zandi anticipates significant corrections—defined as more than a 10 percent peak-to-trough decline—are in the Northeast, the Mid-Atlantic, Florida, California, parts of Arizona, and Las Vegas.

"Any fundamental rise in interest rates will bite hard," Zandi said. "The rise will lock out two key groups that are important to local/regional markets: first-time home buyers and investors (investors

include second home buyers and other buyers in it for the long term, not just those in the market with the intent to flip and get out.)

### “The Bubble” Revisited

Addressing a question that has generated endless speculation in recent years, Thomas Lawler, a housing and mortgage market consultant who worked for Fannie Mae for 22 years, said “Was there a national bubble? Nationwide, no, but in some regions, absolutely.”

Lawler, who spoke on house prices and local dynamics, noted that in some areas, “all of the signs of a bubble were present: a surge in speculative investing; a surge in innovative financing; easy credit and loose underwriting; home inspection waivers; and home purchases sight unseen. You had to be ‘on something’ not to see a bubble in some areas,” he said.

### Housing Finance

With interest rates on the rise, housing finance was a major topic at the conference.

“Housing is the most interest rate sensitive industry in the country,” said Frank Nothaft, vice president and chief economist of Freddie Mac. “Mortgage interest rates, home prices and family incomes – these are the three ingredients that families think about when deciding to buy a home.

“We expect mortgage interest rates to rise slowly through the end of 2006, but they’ll still remain well below historical norms,” Nothaft said. “The affordability problem is a function of increases in home prices.”

He pointed out that among families with prime mortgages, 87 percent of the loans are fixed-rate. “So even if the Federal Reserve continues to raise interest rates, most American families will be insulated because they have fixed-rate mortgages.”

The major tailwinds that have driven loan originations in recent years have swung 180 degrees, and could be major headwinds in the coming years, said Scott Anderson, senior economist for Wells Fargo & Company. These include rising interest rates, weakening demographics, increasing housing inventories, and less investor demand – especially if the stock market picks up.

“The federal reserve is doing its best to take away the punch bowl,” Anderson said. “It should be no surprise that the housing market is going to slow down.”

The NAHB Construction Forecast Conference was sponsored by the National Council of the Housing Industry (NCHI), the Supplier 100 of NAHB, Wells Fargo Home Mortgage, Fannie Mae and Countrywide Home Loans.

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